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IN THE

Supreme Court of the United States

October Term, A. D. 1940.

No. 494

THE UNITED STATES OF AMERICA,
Petitioner,

vs.

JOSEPH T. RYERSON AND EDWARD L. RYERSON, JR., AS EXECUTORS OF THE ESTATE OF MARY M. RYERSON,
Respondents.

BRIEF FOR RESPONDENTS.

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Citations.

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ADDITIONAL STATEMENT OF FACTS.

The parties in this case stipulated (R. 38, 39), and the District Court found as a fact (R. 72), that no greater amount could have been obtained or realized on the insurance policies in question by surrendering them or borrowing on them, or otherwise, than their cash surrender values.

ARGUMENT.

There is one important difference between this case and the *Guggenheim* and *Powers* cases, Nos. 92 and 486. In those cases the policies were assigned simultaneously with issuance or shortly thereafter. In this case the policies were taken out by the taxpayer in 1928 and 1929, and they were not assigned until December, 1934. The purchase of the policies and their assignment were not simultaneous; nor were these policies obtained for the purposes of the gift. The amount "donatively expended" was not the cost of the policies (which, incidentally, was less than their surrender values on the date of the gift), but their value at the time of the transfer. The policies were originally taken out by the taxpayer for her own purposes. The proceeds were made payable to her estate, and they remained in that form for about six years. Whatever special value the policies had to the taxpayer *as insurance* (as distinguished from their value as investments) was presumably gone in 1934 when she decided to give them away.

What the taxpayer assigned in 1934 was merely the insurance company's promises to pay the face amount of the policies, $200,000, upon her death. Obligations of that kind are ordinarily valued by reference to the interest and mortality tables. The tables prescribed in Treasury Regulations 79 (Article 19, Table A) show that the present value on the date of the gift of the right to receive the face amount of the policies was $162,318.[1] This is just

1. When the policies were assigned, in December, 1934, the taxpayer was 79 years old (she was born on August 28, 1855 (R. 45)). Table A in Article 19 of Regulations 79 shows that the present worth of $1 due at the death of a person 79 years old is $0.81159. On this basis, the present value of the face amount of the policies on the date of the gift was 200,000 x $0.81159, or $162,318. Use of the tables in this way to determine the value of a remainder or reversionary interest is prescribed in both the 1933 and 1936 editions of the Regulations. Reg. 79, Art. 19 (7).

$353 more than the value determined by the lower court. The comparative figures are as follows:

Actual cost of policies (in 1928 and 1929) (R. 38, 39)	$157,973.00
Value determined by lower court, based on surrender values	161,965.00
Present worth of face amount of policies as of date of gift, based on tables prescribed in Treasury Regulations	162,318.00
Hypothetical cost of similar new policies if taken out on date of gift	171,426.00

We submit (1) that this case is governed by the Treasury Regulations of 1933 that were in force on the date of the gift, and that under these regulations, the value of the policies was determined by their cash surrender values; (2) that the change made in the regulations in 1936 should not be applied retroactively to the present gifts which were made in 1934; and (3) that on the facts of this case, the lower court was correct in holding that the value of the policies in question was their surrender values—irrespective of the 1933 Regulations, and notwithstanding the 1936 Regulations.

I.

Article 2 (5) of Regulations 79 (1933 edition) which was effective throughout the year 1934 provided as follows:

> "(5) The irrecoverable assignment of a life insurance policy, or the naming of a beneficiary of a policy without retaining any of the legal incidents of ownership therein, constitutes a gift in the amount of the net cash surrender value, if any, plus the prepaid insurance adjusted to the date of the gift."

Although Article 2 dealt generally with transfers reached by the gift tax law, paragraph 5, which is quoted above, goes further and defines the taxable amount of the transfer. That this paragraph was intended to prescribe a rule of valuation, and was so understood by the Bureau, is shown by General Counsel's Memorandum 13147, XIII-1

Cum. Bull. 358 (1934), which gives a number of examples of how the rule would apply to different types of policies.

It is true that the regulation does not specifically mention paid-up or single premium policies. But there is no reason to suppose that a different rule was intended for policies of that kind. A single-premium policy is no different in kind from an annual premium policy. In both contracts, a part of the premium goes into a reserve which makes up the surrender value, and a part is allocated to salesmen's commissions, overhead, and other expenses. In both policies there is a margin between what the insured pays and what he could get back on surrendering the policy. If the value of an ordinary policy on which, say, nineteen premiums have been paid, is determined by its cash surrender value (with minor adjustments on account of the current premium), then it would be illogical to hold that the value of a paid-up policy is based on anything other than its surrender value. Certain types of policies become paid-up after a specified number of premiums have been paid. The more usual forms are the so-called Ten, Twenty and Thirty Payment Life contracts. When one of these policies reaches the paid-up status, it becomes the exact equivalent of a single-premium policy. Yet it was hardly intended that a Twenty Payment Life policy, for example, should be valued on one basis in its nineteenth year and on an entirely different basis in its twentieth year, after it has become paid-up. If not, then no distinction between a single-premium policy and any other type of contract can be justified.

The Regulations, it will be noted, speak in general terms, of "the irrevocable assignment of a life insurance policy." This language is broad enough to cover any policy, whether the premium is payable in one sum or in installments, and no exception is mentioned. The last clause of Article 2 (5) provides for an adjustment of the surrender value to the

date of the gift by adding or subtracting a certain portion of the last annual premium (See G. C. M. 13147, *supra*). The government argues that the regulation was not intended to apply to single-premium policies because as to such policies, this last clause would lead to circuitous and involved computations. But the more reasonable view, we submit, is that the regulation is applicable to all policies, as it purports to be, and that it is only the last clause, about adjustments, that is inapplicable to single-premium policies where no adjustment is necessary. The adjustment, or lack of it, does not appear to be of controlling importance. The substance of the regulation is that the value of an insurance policy is based on its "net cash surrender value."[2]

Article 2 (5) of the 1933 Regulations has been construed to apply to paid-up or single premium policies by three Circuit Courts of Appeals, in addition to the court below.[3] The Board of Tax Appeals reached the same result independently of the regulations.[4] The only contrary decisions are those in *Guggenheim* v. *Rasquin*, 110 F. (2d) 371 (C. C. A. 2d), and *Commissioner* v. *Powers*, ____ F. (2d) ____ (C. C. A. 1st, July 16, 1940), both of which are now before this court,[5] and both of which involved policies that were trans-

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2. This is supported by an unpublished ruling made by the Deputy Commissioner of Internal Revenue in a letter dated Nov. 10, 1932. The letter is quoted in C. C. H. 1932 *Fed. Tax Service*, Vol. 3, par. 6548, as follows:

"Reference is made to your letter of November 2, 1932, in which you request advice as to the manner of valuation of life insurance for gift tax purposes under the Revenue Act of 1932 where the insured makes an irrevocable gift of the policy to the beneficiary.

"In reply you are advised that it is contemplated that the Bureau will accept the cash surrender value in cases such as the case cited.

"Suggestions as to other means of valuation in such cases will be given consideration by the Bureau if and when they are submitted.

"The gift tax regulations will be available on or about January 1, 1933."

3. *Commissioner* v. *Haines*, 104 F. (2d) 854 (C. C. A. 3d); *Helvering* v. *Cronin*, 106 F. (2d) 907 (C. C. A. 8th); *Helvering* v. *Bryan*, 109 F. (2d) 450 (C. C. A. 4th).

4. *Cronin* v. *Commissioner*, 37 B. T. A. 914, affirmed *Helvering* v. *Cronin*, 106 F. (2d) 907 (C. C. A. 8th); *Haines* v. *Commissioner*, 37 B. T. A. 1018, affirmed *Commissioner* v. *Haines*, 104 F. (2d) 854 (C. C. A. 3d).

5. Nos. 92 and 486 respectively.

ferred simultaneously with their issuance, or shortly thereafter. The Circuit Court in the *Guggenheim* case interpreted the 1933 regulation as not intended "for a case where a single premium policy is given away simultaneously with issuance." The majority of the court in the *Powers* case felt that the regulation could not validly be applied to to the policies there involved. Neither of these cases is inconsistent with a holding that the 1933 regulations are applicable to a policy which is assigned long after its acquisition.

The distinction suggested in the *Guggenheim* and *Powers* cases between policies that are assigned contemporaneously with their issuance, and other policies, is supported by a comparison of paragraphs (5) and (6) of Article 2 of the 1933 Regulations. Under paragraph (5), the assignment of a life insurance policy constitutes a gift in the amount of the net cash-surrender value, with certain adjustments; but under paragraph (6) the payment of a premium on a policy owned by another is a gift to the full extent of the premium paid. The application of these two paragraphs might be illustrated thus: A donor has an ordinary life policy on which he has paid ten annual premiums of $100 each, and having a surrender value of, say, $600. He makes an irrevocable assignment of the policy. In the following year, he pays another premium of $100, which increases the surrender value to $660. Under Article 2 (5) of the Regulations, the assignment of the policy is a gift to the extent of only $600, even though the premiums previously paid amounted to $1000; but under Article 2 (6), the payment of the subsequent premium is a gift to the extent of the entire $100. The reason for the first result is that of the $1000 paid in previous years $400 had already been used up for insurance protection, expenses, etc., leaving an "investment" of only $600 on the date of the gift. While in the second case, though it is true that a

portion of the premium payment will likewise be used for current charges, and will not be reflected in the increased value of the policies, yet these charges will then be incurred and paid for the benefit of the assignee, and the entire payment will be made for his account. The total benefit received by the donee in that case will be $100, whether the amount is added to his capital assets or is partly used to pay expenses on his behalf. The assignment of an insurance policy simultaneously with its issuance might be considered as similar to the payment of the later premium. The entire expenditure in such a case could be regarded as having been made for the benefit of the donee; and in that light, the value of the asset purchased—whether or not the purchaser received his money's worth—would be immaterial.

The above distinction is also borne out by the provisions in the Regulations about the valuation of annuities. Article 19 (7) of Regulations 79 (1933 edition) provided as follows:

> "(7) *Annuities, life, remainder, and reversionary interests.*—Where the donor purchases from a life insurance company or other company issuing annuity contracts, an annuity for the donee, the value of the gift is the cost to the donor, except that where the donor reserves the unconditional right to cause the annuity or the cash value thereof to be payable to himself or his creditors, only such payments as are made to the donee prior to the exercise of the reserved right constitutes gifts. The value of annuities otherwise acquired by the donor and by him assigned or in any manner made payable to the donee annually at the end of each year should be determined by using Table A or Table B, part of this article. * * *"

Thus, if a donor purchases from an insurance company "an annuity for the donee" the value of the gift is the cost to the donor, whether that cost is more or less than the annuity is worth. But if the annuity is "otherwise acquired" (which would normally exclude an acquisition

"for the donee") the value is the present worth of the annuity as determined by the standard tables. It is hardly necessary to add that the cost of an annuity purchased from an insurance company is normally greater than the present worth of the expected payments, because of the company's cost of doing business.

A life annuity is the converse of a single-premium life insurance policy. The two contracts correspond to a life estate and a remainder respectively. An insurance company selling a life interest must charge something more than the commuted value of the expected payments; a company selling a remainder must similarly charge something more than the discounted value of the remainder. We believe that the 1933 regulations are susceptible of a construction which will apply a consistent rule to the valuation of both of these interests. Under this rule, when an insurance policy is assigned long after it is acquired, in an entirely unrelated transaction, the amount of the gift is not what that or a similar policy would cost, but what the policy is worth at the time of the assignment. And we submit that the cash surrender value is a fair measure of that worth.

II.

Article 2 (5) of the regulations remained in its original form throughout the years 1934 and 1935. It was not until the 1936 edition that the regulations were amended so as to provide that the value of a paid-up insurance policy is the amount that it would cost to obtain a new policy on the date of the gift. In the meantime, Congress had twice amended the gift tax law[6] without making any changes on this subject. We submit that under these circumstances, the 1936 regulations should not be applied retroactively. *Helvering* v. *R. J. Reynolds Tobacco Co.*, 306 U. S. 110. *First Chrold Corporation* v. *Commissioner*, 306 U. S. 117.

6. Rev. Act of 1934, Sec. 520; Rev. Act of 1935, Sec. 301.

The government seeks to distinguish the *Reynolds* case on the ground that the regulation there involved announced the *nontaxability* of a certain transaction, whereas the regulation here simply deals with the measure of tax on a concededly taxable transaction. But we do not see any difference of substance between announcing that a transaction is nontaxable and announcing that it is taxable only to a certain amount.

The government also suggests that the *Reynolds* case be overruled. We submit that the case should not be overruled. The policy served by empowering the Commissioner to make regulations requires that he be authorized to make regulations *which can be relied upon.* The regulations would have little value if their most explicit provisions can be changed retroactively for no reason other than the Commissioner's desire to discard a tenable theory and adopt a competing one.[7]

It is true that section 1108 (a) of the 1926 Act, as amended in 1934, authorizes the Commissioner to prescribe the extent to which any ruling or regulation shall be applied without retroactive effect. But the purpose of this section was to ameliorate the effect of retroactive changes rather than to encourage such changes, or to give express sanction to them. There is nothing in the legislative history to the contrary. It should be remembered that prior to the enactment of section 1314 of the Revenue Act of 1921, Treasury regulations and Decisions were, if valid, automatically applicable to past as well as future transactions, the same as court decisions. It was to mitigate the harsh effects often produced by such retroactive decisions that Congress made the successive amendments in the statute,

7. The Conference Report on Section 605 of the Revenue Act of 1928 quoted on page 28 of the government's brief in the *Guggenheim* case (No. 92), contains the following:

"It is hoped that this provision will prevent the constant reopening of cases on account of changes in regulations or Treasury decisions, and it is believed that sound administration properly places upon the Government the responsibility and burden of interpreting the law and of prescribing regulations upon which the taxpayers may rely. * * *"

each time increasing the power of the Commissioner to withhold retroactive application from changes in the established practice or interpretation. The power of the Commissioner to amend his regulations, therefore, does not rest on any specific enactment by Congress. In so far as Congress has spoken on the subject, it has expressly authorized the Commissioner to make his new rulings *without* retroactive effect, and it has clearly indicated its intention that changes in the rulings should not be applied retroactively when such application will work inequitable results.[8]

The inequitableness of retroactive changes in the regulations is particularly great in the case of the gift tax which, unlike the estate or income tax, is purely an excise on voluntary transfers. This Court has held that Congress itself has no power to levy a gift tax on past transfers,[9] and in successive amendments of the statute, Congress has expressly provided that the changes made should apply only to future gifts.[10] There is all the more reason for holding that changes in the regulations which have the effect of increasing the tax should apply only to future gifts.

III.

The federal gift tax is closely related to the estate tax, which it was intended to supplement. The two taxes form a system under which the maximum rates (of estate tax) are now over 70%, and it would not be hard to imagine a case where the property with respect to which the assessment is made has to be sold in order to pay the tax.

8. See the excerpt from House Ways and Means Committee Report (H. Rep. 704, 73rd Cong. 2nd Sess.) quoted on pages 30 and 31 of the government's brief in *Guggenheim* v. *Rasquin*, No. 92.

9. *Blodgett* v. *Holden*, 275 U. S. 142; *Untermeyer* v. *Anderson*, 276 U. S. 440.

10. Rev. Act of 1934, Sec. 520(b); Rev. Act of 1935, Sec. 301(c); Rev. Act of 1938, Sec. 505(b); Rev. Act of 1940, Sec. 207.

In such a system, the "value" on which the tax is based ought to bear the closest possible relation to what the property would actually bring if it had to be converted into cash within a reasonable time.

Whatever may be the correct rule with respect to property bought for the purposes of the *gift*, in the case of property previously acquired by the donor for his own purposes and later given away, the amount of the gift is what the property would bring on the market. In the present case, the parties stipulated, and the District Court found, that the surrender values of the policies were $161,965, and that "no greater amount could have been obtained or realized upon the policies by surrendering them or borrowing on them, or otherwise, than these surrender values". (R. 38, 72.) Bearing in mind that the policies were taken out several years prior to the gift, we submit that the value so determined was the proper value of the policies for gift tax purposes.

Value has often been defined as what a willing buyer would pay to a willing seller. In the case of insurance, it usually takes persuasion of a high order to make the buyer willing, for which persuasion the agent receives a substantial commission that is included in the cost of the policy. An insurance policy is a species of property that peculiarly depreciates as soon as it is issued. It is like a suit of clothes that is made to measure, or a machine that is built to individual specifications. The machine might have a subjective value to the purchaser (or the person for whom it is purchased) equal to its cost; but its objective or commercial value is usually less than that amount. If the purchaser of the suit of clothes dies, his inheritance tax would be based, not on what it would cost to replace the suit, but on what the suit could be sold for; and the value in the case of a gift should be no different.

A similar situation, in principle, is presented in the so-called "blockage" valuation cases under the estate tax law. If a decedent dies owning a large block of stock which cannot be sold without depressing the market, it is recognized that the value of the block is less than the amount indicated by the market quotations.[11] This is true even though it is obvious that in order to replace a block of that size, it would be necessary to pay a price at least equal to the market quotations.

The government's brief in the *Guggenheim* case (p. 11) states that in the case of the purchase of an automobile, the purchase price would probably be its value for the purpose of the gift tax statute. We submit that that would depend on whether the automobile was purchased for the donee. If the automobile was purchased by the donor for his own use, and was later given away, the amount of the gift would be the sale value of the automobile at that time, irrespective of its cost; and if the only buyer for the car happened to be the dealer himself, then the price which the dealer was willing to pay would be the measure of that value. Certainly if the owner were to die, it would not be contended that his estate is taxable on the replacement cost of the automobile.

The cases cited on page 13 of the government's brief in the *Guggenheim* case, concerning values recognized in conversion suits, actions for breach of contract, and the like, are not applicable here. Value there is used as a measure of damages, and since the object is to make the plaintiff

11. See *Helvering* v. *Safe Deposit Co.*, 95 F. (2d) 806 (C. C. A. 4th); *Wood* v. *United States*, 29 F. Supp. 853 (Ct. Cls.); *Jenkins* v. *Smith*, 21 F. Supp. 251 (D. C., Conn.); *Knoblock* v. *Smith*, 25 F. Supp. 156 (D. C., Conn.). The Treasury Regulations at one time contained a provision to the contrary, as follows (Reg. 80, Art. 10(c)):

> "The size of holdings of any security to be included in the gross estate is not a relevant factor and will not be considered in such determination."

This provision was deleted in an amendment made in 1939. T. D. 4902, 1939-1 Cum. Bull. (Part 1) 325.

whole, replacement cost is the best measure of that value.[12] For tax purposes, however, the only reasonable measure of value is what the property would bring in cash under normal conditions, and if there is only one possible purchaser or one possible way of realizing on the property, the amount that can be realized in that way represents the value of the property. If any exception is to be made where the property is bought for the donee, on the ground that the entire cost is expended for the donee's benefit, such exception would not be applicable in the present case.

What the taxpayer in the present case assigned to the donees was merely the right to receive $200,000 upon her death. She could have accomplished the same result by giving them a note for $200,000 payable upon her death (without interest) or by making them remaindermen of a $200,000 trust subject to a life estate in herself. In the latter cases, the value of the note or of the remainder interest for either gift or estate tax purposes would be $162,318. This differs by only a trifling amount from the value placed upon the policies by the Circuit Court, and demonstrates the correctness of the Court's decision in that respect.

We respectfully submit that the decision of the Circuit

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12. Even in suits of that nature, the surrender or legal reserve value of the policy, or the commuted value of the expected proceeds, is often used as a measure of damages. See *Lovell* v. *St. Louis Co.*, 111 U. S. 264; *People* v. *Security Life Ins. Co.*, 78 N. Y. 114, 125; *Commonwealth* v. *American Life Insurance Co.*, 162 Pa. 586; *Phoenix* v. *Baker*, 85 Ill. 410; *McDonnell* v. *Ins. Co.*, 85 Ala. 408. In *Carr* v. *Hamilton*, 129 U. S. 252, 256, this Court said:

> "Every person's interest in life insurance is capable of instant and present valuation, almost as certain and determinate as the discount of a note or bill payable in the future. Tables of mortality and of all values dependent thereon are adopted by every company, and furnish an assured basis of computation for this purpose."

The Board of Tax Appeals has held that if an insurance policy is donated to charity, the amount deductible under the income tax law, is the surrender value, plus premiums paid subsequent to the gift. *Behrend* v. *Commissioner*, 23 B. T. A. 1037.

Court of Appeals on the valuation question is correct and should be affirmed.

Respectfully submitted,

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December, 1940.